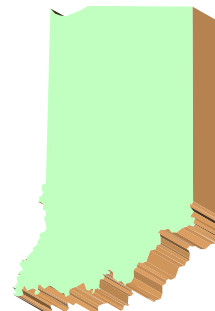




The DFI Update

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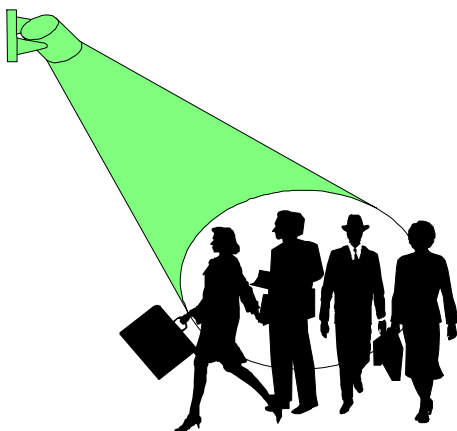
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EMPLOYEE SPOTLIGHT

This section of *The DFI Update* highlights some of the roles and achievements of the Department's employees.

The Department would like to acknowledge that John Schroeder is currently taking courses at Indiana University to earn a law degree.

Congratulations to the following two employees on their promotions!

JANELLE WIGGINS-Janelle was promoted to a PAT III on 11/19/99.

TOM FITE-Tom was promoted to a PAT III on 11/19/99.

Y2K: BANKING AS USUAL!

The Department of Financial Institutions remains confident that Indiana's financial institutions are prepared to meet the Year 2000 challenges. The Department has been working closely with supervised financial institutions and the various Federal (FDIC, Federal Reserve, OTS, NCUA) regulators since mid-1996 to ensure a smooth transition to the Year 2000.

In fact, the financial institutions industry is in very good shape. Various government regulatory agencies agree that the financial services industry is among the best prepared for the Year 2000 date change. As the Federal Financial Institutions Examination Council stated: "The agencies are confident that, based on their reviews, financial institution customers will be able to conduct business as usual both before and after January 1, 2000." As of July 31, 1999, Year 2000 readiness examination findings show that 99.5 percent of all banks and thrifts are rated "satisfactory" in their Y2K preparations. A similar figure is also reported for credit unions.

Throughout the Year 2000 review process, each institution was subject to at least 3 on-site reviews by specially trained examiners. Each institution had to comply with specific Key Milestone dates. Specific time frames by which each institution had to complete the following:

- Year 2000 Plan Development
- Inventory of Software/Hardware
- Identification of Mission Critical Systems
- Year 2000 Test Plan Development

- Testing/Validation of All Systems
- Development of Year 2000 Contingency & Business Resumption Plan
- Testing/Validation of Year 2000 Contingency & Business Resumption Plan

In addition to addressing the above-referenced items, examiners have focused on the Year 2000 liquidity plans of supervised institutions. We have also worked closely with Federal regulators to ensure major data processing providers and software vendors are Y2K compliant. These companies have been under similarly stringent reviews.

The Department continues to work together with other State and Federal regulators to maintain close communication ties as the Year 2000 approaches. Additional contacts with each supervised institution will continue for the remainder of this year and during the rollover weekend. We are confident that the financial services industry as a whole will conduct business as usual throughout the rollover period.

For specific information regarding any insured financial institution's Year 2000 preparedness, please contact that institution. For general guidance on Year 2000 issues and answers to commonly asked questions, please refer to the following websites:

www.dfi.state.in.us

www.fdic.gov

www.ncua.gov

www.ffiec.gov

DEPARTMENT STAFF ATTENDS ANNUAL CONFERENCE

All Department staff members attended the annual examiner's conference held at the Convention Center in Bloomington, Indiana on Wednesday, September 1, 1999 through Friday, September 3, 1999. This is an annual event which brings all of the examination staff together to discuss relevant regulatory and financial industry topics. Time is also scheduled following the daily educational programs for volleyball, softball, and other social activities. Due to the fact that we have office staff and two field staff districts the annual conference provides for interaction between and among staff members who might otherwise not have the opportunity to interact due to their location or daily assignments.

The annual conference has been held at the Bloomington Convention Center for two consecutive years and is popular among staff members due to the lodging and convention center facilities being attached and the proximity to local restaurants and the campus of "the other" Indiana University.

The program included such topics as Year 2000 Event Management, Asset-Liability Management, and other relevant examination and supervisory topics. This year's attendees also included representatives from the FDIC and Federal Reserve and contiguous state banking agencies.

INDUSTRY CONSOLIDATION AND NEW FINANCIAL INSTITUTIONS

As a part of the Department's monitoring process, the staff of the Department follows pending or anticipated mergers and acquisitions. Currently, the Department has seventeen banks that are being tracked as institutions that may be merged out of existence. These seventeen institutions have total assets of approximately \$6.6 billion and are controlled by nine bank holding companies. Since June 30, 1998, sixteen commercial banks have merged out of existence and one savings bank converted to a federal charter. Of these seventeen institutions, only assets from one institution remained under state regulation, the remaining assets totaling \$4.2 billion were removed from state regulation.

This consolidation has slowly drawn the institutions away from local control and into more regional management, and therefore, has heightened the interest of community leaders in forming new banks. A financial institution may not be organized until the requirements established in IC 28-11-5 have been satisfied. Since June 30, 1998, the Department has approved the formation of four commercial banks.

The Department approved Tower Bank and Trust Company on December 10, 1998. This institution officially opened on February 19, 1999. The institution is located in Fort Wayne, Allen County, Indiana. The Department approved Freedom Bank, Huntingburg, Dubois County, Indiana on May 13, 1999. Freedom Bank officially opened November 22, 1999. As of September 30, 1999, Tower Bank and Trust Company had \$83 million in total assets. On August 12, 1999, the Department approved Elkhart Community Bank, Elkhart, Elkhart County, Indiana and Village Bank and Trust of Munster, Munster, Lake County, Indiana. Elkhart Community Bank officially opened on September 9, 1999. The Department also approved United Commerce Bank, Bloomington, Monroe County, Indiana on October 14, 1999. United Commerce Bank is expected to open in the first quarter of 2000.

Additionally, the First Internet Bank of Indiana (FIBI) officially opened for business on December 30, 1998. This institution is located in Indianapolis, Marion County, Indiana and delivers its banking products and services via the Internet. FIBI was the first state chartered pure internet bank to be formed. Total assets of First Internet Bank of Indiana were \$47 million as of June 30, 1999.

Currently, the Department has two commercial bank applications but has not yet accepted them for processing.

SEPTEMBER 30, 1999, FINANCIAL RESULTS

DIVISION OF BANKS AND TRUST COMPANIES DIVISION OF BANKS AND TRUST COMPANIES

From January 1, 1999, to September 30, 1999, the number of state chartered commercial banks, state chartered stock and mutual savings banks, and active industrial authorities declined from 138 to 135. During the same period, total supervised assets increased slightly from \$25.4 billion to \$25.6 billion, a 0.63% increase. As of September 30, 1999, assets of state chartered banks represented 36.8% of total Indiana bank assets (state and national). In contrast, state chartered banks represented 79.4% of the total number of insured depository institutions in Indiana.

The first three calendar quarters of 1999, continue to show the strong trends of Indiana state chartered financial institutions in condition and performance. Annualized net income as a percentage of average assets decreased slightly from 1.26% as of December 31, 1998 to 1.21% as of September 30, 1999. The aggregate allowance for loan and lease losses (ALLL) during the first nine months of the year remained the same as year end 1998, at 1.37% of total loans, and net charge-offs decreased from 0.21% to 0.10% of total loans. Equity capital remains at an adequate level as equity capital slightly increased from 9.16% to 9.24% of total assets from year-end 1998, to September 30, 1999.

During the first nine months of 1999, two new state chartered commercial banks were opened. Tower Bank and Trust Company, Fort Wayne opened February 19, and Elkhart Community Bank, Elkhart opened September 9. Four state bank charters were eliminated through mergers with other state or national banks. One state chartered stock savings bank converted to a federally chartered savings bank.

The information utilized to compile the following schedules including, consolidated balance sheet, consolidated income statement and ratio analysis for all state chartered commercial banks, savings banks, active industrial authorities and national commercial banks, was obtained through the Federal Deposit Insurance Corporation's Database.

ACCOUNT DESCRIPTIONS (IN MILLIONS OF \$)	State 9/30/99	National 9/30/99	State 12/31/98	National 12/31/98	State 12/31/97	National 12/31/97
Number of Banks	135	35	138	38	152	42

Income Statement

Total Interest Income	1,367	2,297	1,780	3,121	1,910	2,986
Total Interest Expense	617	1,006	850	1,470	918	1,328
Net Interest Income	750	1,291	930	1,651	992	1,658
Total Non Interest Income	178	1,257	233	1,052	212	531
Loan Provisions	34	94	55	141	55	125
Total Non Interest Expense	530	1,442	661	1,632	690	1,228
Net Income	223	649	298	632	303	555

Ratio Analysis

Net Income to Average Assets *	1.21%	1.96%	1.26%	1.58%	1.25%	1.42%
Net Income to Total Equity *	12.59%	20.50%	12.81%	14.90%	12.23%	17.51%
Net Interest Income to Average Assets *	4.07%	3.89%	3.93%	4.12%	4.08%	4.24%
Total Loans to Total Deposits	86.91%	95.67%	82.84%	98.24%	83.17%	93.23%
Loan Loss Provisions to Total Loans *	0.26%	0.45%	0.32%	0.41%	0.31%	0.44%
Loan Loss Reserves to Total Loans	1.37%	1.64%	1.37%	1.39%	1.39%	1.53%
Net Charge-Offs to Total Loans *	0.10%	0.40%	0.21%	0.38%	0.20%	0.42%
Total Equity Capital to Total Assets	9.24%	9.62%	9.16%	8.68%	9.41%	7.62%
Total Equity Capital and Reserves to Total Assets and Reserves	10.09%	10.55%	9.98%	9.56%	10.25%	8.58%

* 9/30/99 ratios are annualized for state and national banks. The 9/30/99 ratios for national banks are

distorted due to the merger of NBD Bank, N.A., Indianapolis with and into Bank One Indiana, N.A., Indianapolis.

PAYDAY LENDING INFORMATION
"EXCERPTS FROM TESTIMONY OF MARK TARPEY
DIVISION SUPERVISOR, CONSUMER CREDIT DIVISION,
CONGRESSIONAL FORUM ON PAYDAY LENDING 12/15/1999"

What are “payday” lenders?

“Payday” lending is a term used for marketing purposes by lenders and by others to describe businesses that typically will accept a customer’s personal check and as part of a contractual agreement with the customer, that we believe to be a loan agreement, will hold that check for an agreed upon time. The customer will write the check for the amount of the loan plus the fee, which is interest on the loan. For example, a consumer will receive a one-hundred-dollar loan for two weeks in exchange for a check made out to the payday lender for one hundred and thirty three dollars. The effective Annual Percentage Rate (APR) on this transaction is 860.35%. The term of these transactions is typically 14 days or less.

How long have “payday” lenders been operating in Indiana?

These lenders first came to Indiana in the latter part of 1994. The industry has grown from 11 licensees with 15 locations in 1994 making loans in the amount of \$12,688,599 to 107 licensees with 511 locations as of the end of 1998 with loans during 1998 of \$296,098,015. We currently have 126 licensees with 551 locations.

Are “payday” lenders required to have a written contractual agreement including required disclosures under Federal Truth-In-Lending with the customer?

Yes. IC 24-4.5-3-508(7) and IC 24-4.5-3-301 require that the lender contract for any fee/interest. The statute also requires disclosure of all items required under the Federal Consumer Credit Protection Act for credit transactions. A new written contractual agreement is required each time that the customer comes in to renew/rollover the transaction by paying a fee.

What amount of charge is allowed on payday loan agreements?

The lenders use a provision in IC 24-4.5-3-508(7) of the Indiana Uniform Consumer Credit Code. This provision allows a lender to contract for a flat charge up to what is currently \$33.

Can a payday lender contract for any additional fees on single pay loan agreements in addition to the basic interest/fee of up to \$33?

Yes. A lender can contract for one delinquency charge on the one payment not to exceed \$15.50 if payment is not received within ten (10) days of the due date. They can also contract for one NSF fee of up to \$20. The statute also provides for the payment by the debtor of attorney fees after default and referral to an attorney who is not a salaried employee of the lender, if contracted for.

Is there a limit on how many renewals/rollovers that a “payday” lender can have on these single pay, short-term transactions?

Under current Indiana statute, there is no specific limit on how many times a loan can be renewed or rolled over with the customer paying an additional fee/interest. As noted, the lender is required to issue a new loan agreement, receive a new check, and start the process over. As an alternative, the customer can come in and pay off the loan in cash and get his personal check returned by the lender. The customer also has the option of not going back to the lender and letting the lender deposit their check. The other option is for the customer to go to another payday lender to get a loan to payoff the original lender.

Does the Department have concerns about the handling of renewals/rollovers?

Yes. Regardless of the initial fee for these transactions, the larger issue is the practice of renewing/rolling over these transactions. The customer continues to pay a fee, but the original principal loan amount is not reduced. The customer may be paying several hundred dollars in fees. We have seen loans “renew/rollover” more than 60 times. There is no incentive for the lender to not allow the customer to do this since it results in continuing fee income and repeat business. Another practice is to renew loans without any review of the customer’s ability to repay. For example, making an initial loan for 14 days, but upon renewal reducing the term to 7 days even though the customer’s “payday” is biweekly. The Department has seen transactions for as little as one, three, or five days.

What other potential unconscionable practices have been observed?

The lender does not verify whether the consumer pays rent, has a mortgage, has a car loan, credit card debt, or any other standard measurement of the customer’s ability to repay. This may be a major reason that many consumers have an excessive number of renewals.

Do payday lenders go to court to enforce the terms of their loan agreements?

Under current statute, payday lenders can go to small claims court when the customer has not paid. The Department would agree that the payday lender should be able to enforce the terms of their loan agreement. This would include obtaining a judgment for the amount owed including any permitted additional charges. As noted previously, this could include a delinquency charge, a NSF fee, and attorney fees.

Payday lenders in Indiana have gone to small claims court and rather than collecting under the terms of the loan agreement, they have filed under the “bad check” laws. This allows collection costs and the awarding of treble damages. Three payday lenders in one county have filed over 700 lawsuits in the past 2 years. The ‘bad check’ laws are intended for use by retail businesses that are given checks by customers that have insufficient funds. The laws are to discourage this practice and therefore provide for treble damages. The Department has had concerns raised by some small claims court judges concerning this practice of using “bad check” laws to enforce the terms of a loan agreement.

Do “payday lenders’ use the threat of criminal prosecution?

The Department has had some complaints involving lenders who have threatened criminal prosecution if the customer does not pay including requests that a judge issue a bench warrant for

failure to appear in court when pursuing judgement or threaten arrest if the customer does not pay.

Again, the payday lender is attempting to use the court system to enforce a loan agreement. Because the customer is in default, the payday lender wants to now characterize the transaction as a “bad check” rather than a valid loan agreement.

Does the Department examine these types of lenders?

These lenders are generally examined annually unless no violations were cited on the last examination. In those instances, exams would be every other year. Types of violations found include: charges in excess of the maximum \$33, collecting delinquency charges or NSF fee in excess of the amount allowed, making loans (particularly renewals/rollovers) without a new written agreement with the customer, “splitting” of a loan so that multiple fees can be collected and the lender will then have multiple checks to enforce on collection. The Department has cited 7,781 refundable violations totaling \$343,831. These errors were found during 179 examinations from 1995 through 1999.

What is the “Summary of Payday Lender Examinations” report?

The report was compiled in order to give a more complete picture of the practices of Indiana lenders in the payday loan industry. This summary document is public information and does not include the names of specific lenders or customers.

What did the data attempt to document?

A total of 5,350 customers with a total number of loans in the amount of 54,508 were recorded.

What practices were discovered as part of this survey?

Of the 47 entities examined, 16 entities sued to collect treble damages including NSF fees, late charges; 11 sued to collect principal, late charges, NSF fees; 7 entities were examined before this data was being added to the survey; 6 had no legal accounts; 3 referred accounts to third party collection agencies; 3 sold delinquent accounts to other third parties such as collection attorneys; 1 sued to collect principal and interest only.

Customers freely enter into these transactions both initially and on renewals/rollovers. Where is the problem?

Each state’s legislature must determine whether these types of transactions should be legalized and regulated. The terms and conditions under which these loans will be made must then be determined.

The problem with renewals is that you have an incentive for the lender to continue to collect fees (interest) as long as the customer pays them. There is no incentive to limit renewals/rollovers. Even if you statutorily prohibit or limit renewals/rollovers, you have the problem of a customer coming in and paying cash and the lender then giving them the same funds back and calling it a new loan. There are other practices to conceal transactions from being deemed a renewal/rollover.

The customers may feel that they have to come in and pay the fees rather than risk the lenders taking them to court for treble damages, court costs, etc., or threatening them with possible criminal prosecution. At a minimum, the lenders may deposit the personal check they are holding. If the customer believes the check will not be paid by their depository institution, then they must continue to pay the fee.

The customer clearly owes a debt that should be paid. However, some lenders are using collection practices or the threat of collection practices that are abusive and result in the customer paying fees far in excess of the original principal amount.

Should a payday lender be able to use “bad check” laws?

We believe the lender is entitled to collect under the terms of their loan agreement. They should not be able to use the threat of either civil or criminal laws that govern retail businesses to enforce their loan agreements.

Is education of the customer important?

Yes. The Department’s proposed legislation would have required a “Warning” notice on all agreements putting both the lender and the customer on notice that this is a high rate transaction that is regulated by the Department of Financial Institutions. Any limits on renewals would also be stated in this notice which would be in bold type.

NEW POLICIES APPROVED

The Members of the Indiana Department of Financial Institutions approved the following policies at the December 9, 1999, meeting. The effective dates of the policies are December 9, 1999. The Policy for Establishing a Bank Subsidiary and The Policy Establishing Criteria for Exemption of Dividend Approval by the Department were developed to correspond to legislative changes in the Indiana statutes. The Branch Closing Policy was amended to eliminate the publication and notification requirements since Federal law establishes publication and customer notification requirements. If you have any questions please contact Kirk Schreiber or Gina Williams at (317) 232-3955.

POLICY FOR ESTABLISHING A BANK SUBSIDIARY

I.C. 28-1-1-3(17) defines "subsidiary" as a foreign or domestic corporation or limited liability company in which the parent bank, savings bank, savings association, or industrial loan and investment company had at least eighty percent (80%) ownership before July 1, 1999, or is formed or acquired in accordance with IC 28-13-16 after June 30, 1999.

IC 28-13-16 allows for two types of subsidiaries. A “qualifying subsidiary” is a subsidiary in which a financial institution has more than fifty percent (50%) ownership. A “non-qualifying subsidiary” is a subsidiary in which a financial institution has fifty percent (50%) or less ownership.

The Members of the Department of Financial Institutions establish the following formal procedures for the establishment of a qualifying and non-qualifying subsidiary:

1. Qualifying Subsidiary

Prior to the formation or acquisition of a qualifying subsidiary, the financial institution shall file a letter of notification with the Department of Financial Institutions. The notification shall contain information regarding the capital of the qualifying subsidiary, the authorized powers of the qualifying subsidiary and the amount of investment by the financial institution. The activities of the qualifying subsidiary shall be limited to those activities authorized by the Indiana Financial Institutions Act or authorized by 12 CFR 5.34(e)(2)(ii).

The letter of notification shall have attached a copy or proposed copy of the Articles of Incorporation, or Articles of Organization and Operating Agreement if a limited liability company, of the subsidiary and a current balance sheet of the parent financial institution.

The Deputy Director of Depository Institutions shall review the information received in the letter of notification for compliance with applicable statutes. Unless notified by the Department otherwise, the qualifying subsidiary may begin operations thirty days after the Department receives the letter of notification. The Director shall apprise the Members of the Department at the next regularly scheduled Members' meeting of any subsidiary notification filed the Department. If the qualifying subsidiary is not deemed to be in compliance with applicable statutes, the Deputy Director shall notify the financial institution within 30 days of receiving the letter of notification and the subsidiary shall not be established until such time as compliance is achieved.

2. Non-qualifying Subsidiary

Prior to the formation or acquisition of a non-qualifying subsidiary, the financial institution shall file an application with the Indiana Department of Financial Institutions detailing the information requested in IC 28-13-16-5. The notification shall contain information regarding the capital of the non-qualifying subsidiary, the authorized powers of the non-qualifying subsidiary and the amount of investment by the financial institution. The activities of the non-qualifying subsidiary shall be limited to those activities authorized by the Indiana Financial Institutions Act, authorized by 12 CFR 5.34(e)(2)(ii), or are considered a part of or incidental to the business of banking as determined by the Director of the Department.

The applicant shall attach a copy of the Articles of Incorporation, or Articles of Organization and Operating Agreement if a limited liability company, of the subsidiary and a current balance sheet for the parent financial institution.

If the financial institution intends to have a minority interest in a non-qualifying subsidiary, the investment must conform to the standards imposed upon national banks for such investments. The Office of the Comptroller of the Currency ("OCC") permits national banks to make minority investments in subsidiaries if the following standards are met:

1. The activities of the subsidiary must be limited to the activities that are part of or incidental to, the business of banking;

2. The bank must be able to prevent the subsidiary from engaging in activities that do not meet the foregoing standard;
3. The bank's loss exposure must be limited, as a legal and accounting matter, and the bank must not have open-ended liability for the obligations of the subsidiary; and the investment must be convenient or useful to the bank in carrying out its business and not a mere passive investment unrelated to that bank's banking business.

The financial institution must demonstrate to the Department that all four standards are met and will be maintained throughout the financial institution's investment in the subsidiary.

The Deputy Director of Depository Institutions shall review the information received in the application for compliance with applicable statutes and submit the application to the Director for consideration. Within 60 days from receipt of the application, the financial institution will be notified if the application was approved or disapproved. If the application is approved, the Director shall apprise the Members of the Department at the next regularly scheduled Members' meeting of any non-qualifying application filed with the Department. If the non-qualifying subsidiary is not deemed to be in compliance with applicable statutes, the Deputy Director shall notify the financial institution and the non-qualifying subsidiary shall not be established until there is compliance.

3. Examination of the Subsidiary

Each subsidiary shall be subject to examination by the department and by appropriate federal banking supervisory authorities to the same extent as though it were comprised within the legal entity of the bank or trust company.

This policy has been formerly adopted by the Members of the Indiana Department of Financial Institutions on December 9, 1999.

POLICY FOR CLOSING A BRANCH OFFICE

The Members of the Indiana Department of Financial Institutions establish the following formal procedures for closing a branch office:

1. Whenever any corporation, as defined in IC 28-10-1-4, decides to close a branch office, the board of directors shall adopt a resolution authorizing the closing. The resolution shall establish both the approximate time and date of closing. The President or Chairman of the Board shall send to the Director of the Indiana Department of Financial Institutions a certified copy of the resolution of the board of directors authorizing the closing.
2. The Director of the Department shall place on the agenda of the next regular scheduled only, the fact that the bank is closing the branch office. This item of business does not need any formal action by the Members but the minute book of the Department shall establish the fact that on a certain date a branch office of a particular bank will be closing. The Members of the Department reserve the right to file any objections they deem appropriate.

3. Upon the actual closing of the branch office, the President of the bank shall immediately notify the Deputy Director of Depository Institutions, by letter, that the branch office has been closed. The Deputy Director shall maintain the letter of notification in the files and records of the bank.
4. If a bank, at anytime prior to the closing date of a branch office, by resolution of the Board of Directors, decides not to close the branch, the President shall immediately notify the Deputy Director of Depository Institutions of the Department by sending the Deputy a copy of the resolution. The Deputy shall, at the next regular scheduled meeting of the Members of the Department apprise the Members of such withdrawal.

This policy was formally adopted by the Members of the Indiana Department of the Indiana Department of Financial Institutions on December 9, 1999.

**POLICY ESTABLISHING CRITERIA FOR EXEMPTION OF
DIVIDEND APPROVAL BY THE DEPARTMENT**

The Members of the Department of Financial Institutions establish the following criteria a corporation must meet in order to be exempt from the dividend approval requirement established pursuant to IC 28-13-4-3. All three of the criteria must be met in order for the corporation to be exempt from the approval requirement.

1. The corporation must have received an assigned composite Uniform Financial Institutions Ratings System rating of 1 or 2 as a result of its most recent federal or state examination. In the case of a corporate fiduciary, a Corporate Fiduciary Rating of 1 or 2, as of its most recent state examination, must have been assigned;
2. The proposed dividend would not result in a Tier 1 leverage capital ratio below 6.5% as calculated by Part 325 of the FDIC Rules and Regulations; and,
3. The corporation is not subject to any corrective or supervisory order or agreement.

A notification letter should be sent to the Department prior to the payment of the dividend. The letter shall state the amount of the proposed dividend and the corporation's proforma Tier 1 leverage capital ratio after the payment of the dividend. The board minutes of the corporation should state that the proposed dividend exceeds the limitation prescribed in IC 28-13-4-3; however, because the corporation meets the criteria established in this policy, the Department's approval was not required.

This policy was formally adopted by the Members of the Indiana Department of the Indiana Department of Financial Institutions on December 9, 1999.

***WANTED:* YOUR IDEAS, SUGGESTIONS, AND OBSERVATIONS**

We are always striving to improve this newsletter, and listening to our readers' suggestions is one way to accomplish this task. Please, if you have any comments or suggestions, feel free to contact Jim Cooper or Tracy Baker at the addresses or numbers below. We are proud of our state banking system and the people who strive to make it work!

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